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UNCLAS SECTION 01 OF 02 KOLONIA 000011

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DEPARTMENT FOR EAP PDAS GLYN DAVIES AND EAP/ANP
INTERIOR FOR OIA DIRECTOR NIKOLAO PULA

E.O. 12958: N/A

TAGS: [EPET](#) [ENRG](#) [ECON](#) [PGOV](#) [FM](#) [RM](#)

SUBJECT: POHNPEI'S FUEL SITUATION HEATS UP

REF: 07 KOLONIA 000146

11. (SBU) Summary. Pohnpei's outgoing governor engineered a secretive memorandum of understanding on fuel between the

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Pohnpei Utilities Corporation and a South Korean firm. Signed before the closing date and review of bids on the PUC's Invitation to Bid for fuel, the MOU appears to be in violation of Pohnpei law. Mobil Oil reportedly is suing in retaliation. Managing this controversy will be Governor Ehsa's first political test and could reveal much about the nature of Pohnpei's new leadership and its approach to the FSM's core issues of energy and federalism. End summary.

12. (U) In the final weekend of his administration, then-Pohnpei Governor Johnny David reportedly flew with a small contingent of Pohnpei Utilities Corporation (PUC) executives to Guam, where they negotiated a memorandum of understanding between PUC and SK Shipping, a subsidiary of South Korean chaebol SK Corporation. The MOU is for a fuel supply agreement that would enable PUC, the largest consumer of fuel on Pohnpei, to break from its dependence on Mobil Oil Micronesia, Inc. (MOMI), which has operated a fuel monopoly in the Federated States of Micronesia (FSM) since 1965.

13. (U) The FSM and Mobil are exploring ways to refashion their relationship. Last year, the FSM Government created the National Fuels Corporation (NFC), which was designed to use a nearly USD 10 million loan from the Bank of Guam to purchase and assume all MOMI operations in the FSM, contingent on approval by all four FSM states (Chuuk, Kosrae, Pohnpei and Yap). The corporation was also to commit the FSM to a new five-year supply contract with MOMI. All four states apparently indicated their acceptance of the plan at a meeting of the Chief Executive Council (consisting of the FSM president, vice president, and state governors), albeit with certain understandings. Pohnpei and Yap, in particular, claimed to have relied on the assurance that the NFC would operate the fuel facilities on a temporary basis only, with divestment of the facilities to their respective states to occur upon each state's purchase of those facilities. Yap continues to support the plan, but Pohnpei retracted its support for the NFC soon afterward, when it became aware that divestment would require the unanimous consent of the Chief Executive Council and could occur only after the FSM Government had cleared all contractual obligations.

14. (SBU) The Pohnpei Legislature cited the differences in understanding as one of several reasons for its opposition to joining the NFC. The legislature raised other concerns, including environmental and anti-trust liability, fears of

adverse consumer impact, and the proposed corporation's susceptibility to political pressure. Some suggest that the final point may partly have been code for the lawmakers' opposition to the role of controversial former FSM Speaker Peter Christian of Pohnpei in the leadership of the NFC.

¶5. (U) On December 11, 2007, the PUC advertised an Invitation to Bid that was not to close until January 23, 2008. The closing date notwithstanding, Governor David and the PUC representatives reportedly signed their MOU with SK Shipping on January 12. (Because no copy of the MOU has been publicly released, Embassy cannot confirm the date.)

¶6. (U) On January 16, MOMI wrote to newly-inaugurated Governor John Ehsa to summarize the benefits to Pohnpei of MOMI's bundled offer to the FSM and to complain that PUC had violated due process by executing a supply contract with another supplier before the closing date for bids. On the same day, the PUC claimed in a letter to MOMI that its MOU with MOMI's competitor was necessary to secure "open competition that would otherwise be lost because of hostile maneuvering" and that in any case would not preclude PUC from accepting a more preferential offer from MOMI.

¶7. (U) On the afternoon of January 18, MOMI representatives called on Ambassador to brief her on developments and to share with her an advance copy of a letter from their attorney addressed to the PUC with copies to the FSM and Pohnpei leadership. The letter accused PUC of subverting the competitive bid process established by Pohnpei law and closed by threatening to "utilize all available legal remedies" were the situation not rectified by January 21. MOMI informed Ambassador that its shareholders had agreed to file a restraining order against PUC on January 21.

¶8. (U) During dinner with Deputy Chief of Mission on January 16, Governor Ehsa related how PUC had enthusiastically shared with him its proposal for using a different source for fuel for

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power plant operations. Ehsa said he had told them that, as governor, he needed to take a larger view; he feared that the diminution in bulk purchases from Mobil would lead to higher gas prices and more that offset any gains to the consumer. He was satisfied that his points had effectively punctured PUC's argument.

¶9. (SBU) In Ambassador's first courtesy call on Governor Ehsa on January 18, Ehsa informed her of his intention to call on all parties to observe a "time out" for 30 days before taking any further action. His stated goal was to resolve the controversy as amicably as possible with minimal damage. He suggested that PUC could re-let the bid in conformity with the law. On January 24, a source advised that Mobil Oil had sent, and then retracted, a letter to President Mori declaring its intention to end all operations in the FSM. That evening, Embassy officers learned that Mobil Oil had filed suit against the PUC.

¶10. (SBU) Comment. Ehsa likely will repudiate the deal with SK negotiated by his predecessor, then lead Pohnpei into endorsing the National Fuels Corporation. After all, Ehsa probably won his election as governor in large part through the generous support of his wealthy mentor, former Speaker Peter Christian. It is unlikely Ehsa will support Pohnpei's continued hold-out against joining the NFC, given the importance to him of Christian's backing. In fact, when Ehsa paid his courtesy call on President Mori in Palikir, Christian accompanied him and did much of the talking. When Ehsa and Christian left, Mori asked his staff: "what was that about?" Answered a leading cabinet officer, "Christian just wanted to show you who is really in charge in Pohnpei." If Ehsa is truly playing cat's paw to Christian, he will support the establishment of the NFC.

¶11. (SBU) Comment continued. Oil has many uses, politically as well as physically. Oil is a salve, a critical commodity around which the loose Micronesian federation could organize and

progress toward stronger unity, in much the way that the European Community first evolved from a commodity union for coal and steel. Optimistically, the National Fuels Corporation could provide the initial structure for such cooperation. Oil is also a flammable. Rising oil prices are causing the island economies to become ever more precarious and destroying the prospects for the United States and the FSM to achieve our joint goals of FSM economic self-sufficiency by the year 2023. Replacement of MOMI by a publicly-owned corporation is probably not the panacea many hope. The neighboring Republic of the Marshall Islands has suffered chronic fuel shortages ever since MOMI pulled out one year ago, and a power outage again looms for Majuro because an SK tanker was delayed by severe storms. Kosrae's state-owned Micronesian Petroleum Corporation has encountered problem after problem, at one point completely running out of fuel and at another causing Continental Micronesia, the sole international carrier in the FSM, to suspend flights to Kosrae for several weeks because of tainted fuel. In fact, the move to a National Fuel Corporation could be disastrous if it creates insurance or other liability issues that force Continental Micronesia to curtail or cease altogether its service in the islands. This would likely result in the collapse of the FSM economy and conceivably cause the political dissolution of the FSM.

Finally, oil is also a lubricant, which in Micronesia seems to increase its viscosity at election time. Ehsa understands that.

MOMI's monopoly has been expensive for Pohnpei, but it has assured stable fuel supplies. To maintain that stability while transitioning to the NFC will be a major challenge for the FSM and particularly Pohnpei's new Ehsa-Christian leadership tandem.

End comment.

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